Office of the Legislative Auditor

State of Montana

Report to the Legislature

February 1991

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 1990

Teachers' Retirement Division

Department of Administration

This report contains an unqualified opinion on the financial schedules and does not contain any recommendations.

Direct comments/inquiries to:
Office of the Legislative Auditor
Room 135, State Capitol
Helena, Montana 59620

90-16

FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Office of the Legislative Auditor to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations which could have a significant financial impact. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act of 1984 and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports regarding the state's federal financial assistance programs, including all findings of noncompliance and questioned costs. This individual agency audit report is not intended to comply with the Single Audit Act of 1984 or OMB Circular A-128 and is therefore not intended for distribution to federal grantor agencies. The Office of the Legislative Auditor issues a statewide biennial Single Audit Report which complies with the reporting requirements listed above. The Single Audit Report for the two fiscal years ended June 30, 1989 has been issued. Copies of the Single Audit Report can be obtained by contacting:

Office of the Legislative Auditor
Room 135, State Capitol
Helena, MT 59620

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STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLETT
Financial-Compliance Audit

JIM PELLEGRINI
Performance Audit

February 1991

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Teachers' Retirement Division of the Department of Administration for the two fiscal years ended June 30, 1990. We thank the administrator and his staff for their assistance and cooperation.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

Office of the Legislative Auditor

Financial-Compliance Audit
For Two Fiscal Years Ended June 30, 1990

Teachers' Retirement Division

Department of Administration

Members of the audit staff involved in this audit were: Mark C. Barry, Renee Foster, Tori Hunthausen, Geralyn Huschka, Charles V. Jensen, Wayne Kedish, and Julie Quist.

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Appointed and Administrative Officials

Retirement Board

		Term Expires
James E. Cowan, Chairman	Seeley Lake	1992
Virginia Egli	Glendive	1991
Verna M. Green	Helena	1993
John U. Kranick	Great Falls	1993
W. Craig Brewington	Fort Benton	1994
Nancy Keenan Superintendent of Public Instruction		Ex-officio

Administrative Officials

David L. Senn, Administrator

Mary L. Harrington, Assistant Administrator

Introduction

We performed a financial-compliance audit of the Teachers' Retirement Division (division) for the two fiscal years ended June 30, 1990. The audit objectives were to:

1. Recommend improvements in the division's management and internal controls.

2. Determine implementation status of prior audit recommendations.

3. Determine the division's compliance with applicable laws and regulations.

4. Determine if the financial schedules present fairly the results of the division's operations for the two fiscal years ended June 30, 1990.

Background

The Montana Teachers' Retirement System, established by state law in 1937, currently has more than 15,700 active members and 1,137 vested inactive members. Approximately 6,560 retirees or their beneficiaries received retirement, disability, or survivor benefits in June 1990.

A six-member retirement board governs the retirement system. The responsibilities of the board include:

1. Establishing rules and regulations necessary for the proper administration and operation of the retirement system.

2. Determining the eligibility of a person who is applying for membership in the system.

3. Granting retirement, disability, and other benefits under the provisions of Title 19, chapter 4, MCA.

4. Designating an actuary to provide consultation on the technical actuarial aspects of the retirement system.

Membership in the retirement system is compulsory for all full-time members of the teaching profession. Substitute teachers may become a member of the retirement system on the first day of employment in any fiscal year and must become an active

member on the thirty-first day of employment in any fiscal year. Effective July 1, 1987, Chapter 494, Laws of 1987, gave the Board of Regents the authority to establish an optional retirement system for instructional staff of the Montana University System. By law, eligible employees of the university system are allowed to waive participation in the Teachers' Retirement System. As of June 30, 1990, 523 members have elected this waiver.

In accordance with section 19-4-207, MCA, the Teachers' Retirement Board also established a tax-deferred annuity program for teachers which conforms with the provisions of section 403(b) of the Internal Revenue code. At the end of calendar year 1989, the division transferred the money in the Tax Shelter Annuity Fund to a third-party administering company - Valuable Annuity Life Insurance Company (VALIC). As of June 30, 1990, 308 participants were enrolled in the Tax Sheltered Annuity Fund.

The retirement system is funded by contributions from active members and their employers, and by earnings on the system's investments. Active members' contributions consist of 7.044 percent of their earned compensation, while employers contribute 7.459 percent of the earned compensation of each member employed. Because of the current method in which contributions are made, they are exempt from income tax to the employees until benefits are drawn against those contributions. The Montana Board of Investments invests assets of the system in the various securities permitted by law.

The division contracts for a biennial actuarial valuation of the retirement system. The system's actuary completed the most recent valuation as of July 1, 1989. The purpose of the valuation was to determine the financial position of the fund, the normal cost, and the unfunded accrued liability based upon present and prospective assets and liabilities of the system. The actuary used the entry age normal cost funding method in the valuation. At July 1, 1987, the amortization period for the $586,200,249 in unfunded liability was 36.47 years. The results of the actuary's July 1, 1989 valuation indicate the system was

funded on an actuarially sound basis. The unfunded accrued liability was $602,528,707 as of July 1, 1989. The amortization period for the current unfunded liability was 36.31 years at July 1, 1989. According to the actuary, "ideally, this period of amortization would have declined two years . . ., Several factors, including actuarial assumption changes, contributed to the change in projected funding rates."

Prior Audit Recommendations

Prior Audit Recommendations

Our prior audit report, issued for the two fiscal years ended June 30, 1988, contained four recommendations to the division. The division implemented the four recommendations.

Independent Auditor's Report & Agency Financial Schedules

Summary of Independent Auditor's Report

Summary of Independent Auditor's Report

The auditor's opinion issued on the financial schedules contained in this report is intended to convey to the reader the degree of reliance which can be placed on the amounts presented. The reader may rely on the fairness of the amounts on the schedules presented on pages 8 through 14 when analyzing the financial activity of the Teachers' Retirement Division.

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INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedule of Assets, Liabilities, and Fund Balance, Pension Trust Fund, for the Teachers' Retirement Division as of June 30, 1989 and 1990, and the related Schedule of Revenues, Expenses, and Changes in Fund Balance, Pension Trust Fund, for each of the two fiscal years ended June 30, 1990. These financial schedules are the responsibility of the Teachers' Retirement Division management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the division's financial schedules are prepared in accordance with state accounting policy. Accordingly, the accompanying financial schedules are not intended to present the financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial schedules referred to above present fairly, in all material respects, the financial position of the Teachers' Retirement Division as of June 30, 1989 and 1990, and the results of operations and changes in fund balance for each of the two fiscal years ended June 30, 1990, in conformity with the basis of accounting described in Note 1.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

October 26, 1990

TEACHERS' RETIREMENT DIVISION
SCHEDULE OF ASSETS, LIABILITIES, AND FUND BALANCE
PENSION TRUST FUND
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1990

	1990	1989
ASSETS:		
Cash	$ 2,148,016	$ 3,543,688
Investment Receivable	13,838,642	12,783,167
Accounts Receivable	6,488,773	4,884,711
Investments (net)	662,027,155	599,698,216
Deferred Losses	5,018,846	5,662,454
Land and Buildings	193,844	193,844
Less: Accumulated Depreciation	(75,901)	(72,137)
Equipment	72,077	57,822
Less: Accumulated Depreciation	(34,121)	(26,954)
Intangible Assets	4,384	4,481
Total Assets	689,681,715	626,729,292
LIABILITIES AND FUND BALANCE:		
Accounts Payable	401,949	1,723,389[1]
Accrued Expenditures	52,038	38,952
Property Held in Trust	(21,150)	(1,801)
Compensated Absences	23,730	22,670
Total Liabilities	456,567	1,783,210
Fund Balance	689,225,148	624,946,082
TOTAL LIABILITIES AND FUND BALANCE	$689,681,715	$626,729,292

[1]See note 7 on page 14.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 10 through 14.

TEACHERS' RETIREMENT DIVISION
SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN FUND BALANCE
PENSION TRUST FUND
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1990

	1990	1989
Revenues		
Employee Contributions	$ 30,549,467	$ 28,995,301
Employer Contributions	30,216,213	28,167,393
TIAA-CREF Contributions	430,215[2]	489,891[2]
Investment Income and Dividends	63,582,160	58,753,844
Total Revenue	124,778,055	116,406,429
Expenses		
Benefits	51,036,174	47,212,581
Refunds	8,558,787[1]	5,215,507
Administration	509,997	463,912
Depreciation Expenses	10,931	10,644
Total Expenses	60,115,889	52,902,644
Excess Revenues over Expenses	64,662,166	63,503,785
Other Sources		
Transfers In	160,737	240,748
Excess Revenues over Expenses and Other Sources	64,822,903	63,744,533
Beginning Fund Balance	624,946,082	561,331,967
Prior Year Adjustments	(543,837)	(130,418)
Ending Fund Balance	$689,225,148	$624,946,082

[1] See note 6 on page 13.

[2] See note 3 on page 12.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 10 through 14.

1. Summary of Significant Accounting Policies

The following is a summary of significant accounting policies for the Teachers' Retirement Division.

Basis of Presentation

The financial schedules are prepared from the Statewide Budgeting and Accounting System (SBAS) without adjustments. Accounts are organized on the basis of funds according to state law. The following funds are used by the division:

Trust Funds - A trust fund is used to account for assets held by the division in a trustee capacity. The Pension Trust Fund is used to account for the Teachers' Retirement System. The Fullam Trust Fund is a teacher's estate bequest to the Teachers' Retirement System. This trust is recorded on SBAS in the Expendable Trust Fund. Because the Fullam Trust Fund was bequeathed to the Teachers' Retirement System, it is included in the Pension Trust Fund for financial reporting purposes.

Basis of Accounting

The Teachers' Retirement Division uses the accrual basis of accounting. Under the accrual basis of accounting, revenue is recorded when earned, and an expense is recorded when incurred. Expenses are incurred during an accounting period when a valid obligation exists except for the following items which are also considered valid obligations under state accounting policy.

- If the appropriation provided funds to complete a given project, the entire amount of a service contract may be accrued even though the services are rendered in fiscal years subsequent to the fiscal year in which the expense is accrued.

- The anticipated cost of equipment is expensed in the fiscal year in which the purchase order is issued.

- Goods ordered, but not received as of the fiscal year-end, may be accrued if the purchase order was issued in the fiscal year in which the anticipated expense is to be accrued.

Vacation and Sick Leave

Division employees accumulate both vacation and sick leave. Employees are paid for 100 percent of unused vacation and 25 percent of unused sick leave hours upon termination. Expenditures for compensated absences currently are absorbed in the annual operating costs of the division. At June 30, 1990, the division had an approximate liability of $15,690 for annual leave and $8,040 for sick leave.

Valuation of Investments

Investments are stated at cost. Federal and corporate securities included in the division's investments are increased by the amount of unamortized bond premiums and decreased by unamortized bond discounts. The market value of the investments was $711,722,326 as of June 30, 1990.

Losses on Bond Swaps

The deferral and amortization method was used to account for gains and losses on bond swaps. The unamortized deferred gains or losses are written off over the life of either the bond sold or acquired, whichever is less. The division had net unamortized deferred losses in fiscal year 1988-89 of $5,662,454 (unamortized deferred gains of $6,403,042 less unamortized deferred losses of $12,065,496) and $5,018,846 (unamortized deferred gains of $6,073,593 less unamortized deferred losses of $11,092,439) in fiscal year 1989-90.

2. Description of Plan

The Teachers' Retirement System is a defined benefit plan that covers all full-time teachers in the state of Montana except Montana University System employees who choose an optional retirement system. Substitute teachers may become a member of the retirement system on the first day of employment in any fiscal year and must become an active member on the thirty-first day of employment in any fiscal year. The employee's contribution to the plan is 7.044 percent of salary and is made pursuant to section 414(h)(2) of the Federal Internal Revenue Code of 1954, as amended and applicable on July 1, 1985. Because of the current method in which contributions are made, they are exempt from income tax to the employee until benefits are drawn against these contributions. The employer pays an

amount equal to 7.459 percent of the employee's salary to the retirement system.

A detailed description of the Teachers' Retirement System plan can be found in Title 19, chapter 4, of the Montana Code Annotated, and in the Montana Teachers' Retirement System Handbook of Information available upon request from the Teachers' Retirement Division, 1500 Sixth Avenue, Helena, Montana 59620.

3. Optional Retirement System

Chapter 494, Laws of 1987, gave the Board of Regents the authority to establish an optional retirement system for members of the Montana University System, effective July 1, 1987. As of June 30, 1990, 523 members of the Teachers' Retirement System are enrolled in an optional retirement system, Teachers' Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF). Under state law, the employer must make a separate contribution to Teachers' Retirement System for those employees under the optional program.

4. Unfunded Accrued Liability

The method of funding employed in the actuarial valuation of the retirement systems as of July 1, 1989, is commonly referred to as the entry age normal cost method. This method establishes a normal cost of the system, as well as an unfunded percentage of total salaries required to fund the benefits, assuming this percentage had been contributed since each member's entry into the system.

The unfunded accrued liability represents the excess of the present value of total liabilities over the present value of total assets of the system and the present value of expected future contributions for normal costs. The unfunded accrued liability calculated by the system's actuary was $602,528,707 as of June 30, 1989. The amortization period of the unfunded liability was determined to be 36.31 years.

The results of the July 1, 1989 valuation indicate the system was funded on an actuarially sound basis. This means that the

present employee/employer contribution rate is sufficient to fund the unfunded liability and the benefits as they accrue.

A supplement to the July 1, 1989 valuation was prepared as of June 30, 1990 in order to comply with Governmental Accounting Standards Board (GASB) Statement #5 disclosure requirements. The system's actuary utilized the projected unit credit actuarial cost method, as required by GASB #5, to calculate the unfunded pension benefit obligation of $517,566,863.

5. Actuarial Assumptions

At the request of the Teachers' Retirement Board, during fiscal year 1989-90, the actuary conducted a review of the actuarial assumptions as of June 30, 1989. As a result, the following changes were made:

- The basis for the mortality rate was changed from the 1971 to the 1983 Group Annuity Mortality Rate Table. In addition, to reflect a lower mortality rate for teachers than the general population, the rates for retired members were set back one year and for active members two years.

- The basis for disability rates are based on the 1983 Disability Table. Again, to recognize favorable experience, these rates were reduced by 10 percent.

- Withdrawal rates were adjusted to reflect the reduced rate of termination among the system's members.

6. Tax Shelter Annuity Fund - VALIC

At the end of the calendar year 1989, the Teachers' Retirement Board transferred the money in the Tax Shelter Annuity Fund to a third-party administering company - Valuable Annuity Life Insurance Company (VALIC). The division recorded this transfer as a refund. As a result, refunds increased by approximately $3.4 million in fiscal year 1989-90. As of June 30, 1990, 308 participants were enrolled in the Tax Shelter Annuity Fund.

7. Accounts Payable

On June 30, 1989, the Board of Investments (BOI), purchased a $1,000,000 investment for Teachers' Retirement Trust Fund which was recorded as a credit to accounts payable.

TEACHERS' RETIREMENT SYSTEM

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STAN STEPHENS, GOVERNOR

STATE OF MONTANA

DAVID L. SENN, EXECUTIVE SECRETARY

MARY L. HARRINGTON, ASS'T EXECUTIVE SECRETARY

RECEIVED
7 1991

January 16, 1991

Scott Seacat
Legislative Auditor
Capitol Building
Helena, MT 59620

Dear Mr. Seacat:

I would like to extend the board's appreciation to the members of the audit team for their consideration, courtesies extended to the staff of the Teachers' Retirement System during the audit for the fiscal years ending June 30, 1990. We were pleased with the findings of this report and will work hard to continue to provide the highest quality service possible to the members of the Teachers' Retirement System.

Sincerely,

David L. Senn

David L. Senn
Executive Secretary

DLS/dm